

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of

Section 272(f)(1) Sunset of the
BOC Separate Affiliate and
Related Requirements

WC Docket No. 02-112

Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

August 5, 2002

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DECLARATION OF LEE L. SELWYN

1 Introduction

2

3 Lee L. Selwyn, of lawful age, declares and says as follows

4

5 I My name is Lee L. Selwyn, I am President of Economics and Technology, Inc
6 ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108 ETI is a research and
7 consulting firm specializing in telecommunications and public utility regulation and public
8 policy. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part
9 hereof. I have been asked by AT&T to review the *Notice of Proposed Rulemaking*
10 ("NPRM") issued by the Commission in the above-captioned proceeding, to analyze the issues
11 and questions raised therein, and to provide the Commission with specific recommendations
12 thereon

13

1 2 I have participated in proceedings before the Federal Communications Commission
2 ("FCC" or "Commission") dating back to 1967 and have appeared as an expert witness in
3 hundreds of state proceedings before more than forty state public utility commissions. I have
4 participated in numerous regulatory proceedings involving public utility affiliate relationships
5 and inter-affiliate transactions and transfers. These have included merger proceedings before
6 the California PUC involving Pacific Telesis Group and SBC, and Bell Atlantic and GTE,
7 before the Illinois Commerce Commission involving SBC and Ameritech, before the
8 Connecticut Department of Public Utility Control involving SBC and SNET, and before the
9 Maine PUC involving NYNEX and Bell Atlantic. I also participated in written comments
10 filed with the FCC regarding both the SBC/Ameritech and Bell Atlantic/GTE merger appli-
11 cations. I have participated in a number of Section 271 proceedings, including those in
12 Pennsylvania, New Jersey, California, Minnesota, Delaware and Virginia. I have also
13 submitted testimony before several state commissions addressing proposals for structural
14 separation of ILEC wholesale and retail operations. I participated in proceedings before the
15 California PUC involving Pacific Bell's reorganization of its Information Services (primarily
16 voice mail) business into a separate subsidiary, and the spin-off of Pacific Telesis Group's
17 wireless services business into a separate company. I have participated in a number of
18 matters involving the treatment of transfers of yellow pages publishing from the ILEC to a
19 separate directory publishing affiliate, including the recent case before the Washington
20 Utilities and Transportation Commission addressing imputation of (then) US WEST yellow
21 pages revenues

22

1 **Summary**
2

3 3 Congress established the requirement for structural separation of the BOC ILEC and
4 long distance entities and the associated transactional and nondiscrimination requirements
5 because it understood that mere satisfaction of the Section 272(c)(2)(B) “competitive
6 checklist” was not by itself sufficient to constrain or otherwise diminish a BOC’s market
7 power with respect to local and access services. Absent appropriate safeguards and the means
8 to enforce them, BOCs have both the capability, as an economic matter, and the strong
9 financial and business incentive, to leverage their local service market power over to the
10 adjacent, and presently highly competitive interLATA long distance market. It is thus
11 critically important that the separate affiliate requirement and its associated safeguards be
12 retained in place until competition for local and access services has developed to the point
13 where that capability is no longer present
14

15 4 In fact, local and access services competition has not increased significantly in
16 markets where Section 271 approval has been granted, due to the persistence of material
17 economic barriers to entry and discriminatory conduct by the BOCs. Sections 272(b), (c) and
18 (e) all *require* that (with the limited exception of certain activities related to joint marketing
19 of local and long distance services) BOCs afford the same or superior treatment to competing
20 firms with respect to pricing, service availability, service quality, and other terms and
21 conditions, that the BOCs provide to their own long distance business. However, even with
22 the relative transparency provided by Section 272, BOCs have persisted in “pushing the
23 envelope” with respect to their inter-affiliate transactions, resulting in uncompensated transfers

1 of employees, assets and services the effect of which is to force customers of the monopoly
2 ILEC entity to cross-subsidize the BOC's long distance service. Only those antidiscrimination
3 safeguards provided for at Sections 272(e) would survive the separate affiliate sunset. Thus,
4 in addition to creating a number of additional opportunities for discriminatory treatment of
5 rivals, allowing the separate affiliate requirement to sunset would, as a practical matter, make
6 detection of even the remaining antidiscrimination safeguards extremely difficult and in many
7 cases virtually impossible. Extending the sunset will enable the Commission and the public
8 to monitor such misconduct and thereby facilitate remedial measures that would work to
9 curtail it. It is essential that the Section 272 separate affiliate and the associated transactional
10 and nondiscriminatory requirements be retained. Moreover, in view of documented efforts by
11 BOCs to flaunt these statutory obligations and Commission rules, the Commission should
12 adopt additional measures that will help to assure full compliance with applicable law and
13 regulation. If Section 272 is allowed to sunset at this time, there is a substantial risk that
14 competition in both the local and long distance sectors will be rapidly eroded, and that the
15 BOCs will come to dominate and thereby to remonopolize the (currently highly competitive)
16 long distance market as well.
17

1 **Background**
2

3 5 Structural separation of the BOC and long distance entities is required by Section
4 272(a) for the first three (3) years following a BOC's receipt of Section 271 authority in a
5 particular state,¹ and may thereafter be extended indefinitely by the FCC. Interactions
6 between the structurally separated BOC and long distance entities with respect to the use or
7 provision of common or shared resources must conform to a set of five conduct provisions set
8 out at Section 272(b) and nondiscrimination requirements set out at Sections 272(c) and
9 272(e). The Section 272(b) code of conduct requires that the BOC's long distance affiliate:

- 10
11 (1) shall operate independently from the Bell operating company,
12
13 (2) shall maintain books, records, and accounts in the manner prescribed by the
14 Commission which shall be separate from the books, records, and accounts
15 maintained by the Bell operating company of which it is an affiliate;
16
17 (3) shall have separate officers, directors, and employees from the Bell operating
18 company of which it is an affiliate,
19
20 (4) may not obtain credit under any arrangement that would permit a creditor, upon
21 default, to have recourse to the assets of the Bell operating company, and
22
23 (5) shall conduct all transactions with the Bell operating company of which it is an
24 affiliate on an arm's length basis with any such transactions reduced to writing
25 and available for public inspection.
26

27 1 47 U.S.C. § 272(b). The FCC has specifically characterized these requirements as
28 "structural separation" in *Implementation of the Non-Accounting Safeguards of Sections 271*
29 *and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First
30 Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996)
31 (*Non-Accounting Safeguards Order*), at 11 FCC Rcd 21914

1 The Section 272(c) nondiscrimination provisions require that in its dealings with its long
2 distance affiliate, a BOC

3
4 (1) may not discriminate between that company or affiliate and any other entity in the
5 provision or procurement of goods, services, facilities, and information, or in the
6 establishment of standards, and

7
8 (2) shall account for all transactions with an affiliate described in subsection (a) in
9 accordance with accounting principles designated or approved by the Commission
10

11 Section 272(e) requires that a BOC and its long distance affiliate.

12
13 (1) shall fulfill any requests from an unaffiliated entity for telephone exchange service
14 and exchange access within a period no longer than the period in which it provides
15 such telephone exchange service and exchange access to itself or to its affiliates,
16

17 (2) shall not provide any facilities, services, or information concerning its provision of
18 exchange access to the affiliate described in subsection (a) unless such facilities,
19 services, or information are made available to other providers of interLATA services
20 in that market on the same terms and conditions,
21

22 (3) shall charge the affiliate described in subsection (a), or impute to itself (if using the
23 access for its provision of its own services), an amount for access to its telephone
24 exchange service and exchange access that is no less than the amount charged to any
25 unaffiliated interexchange carriers for such service; and
26

27 (4) may provide any interLATA or intraLATA facilities or services to its interLATA
28 affiliate if such services or facilities are made available to all carriers at the same
29 rates and on the same terms and conditions, and so long as the costs are
30 appropriately allocated
31

1 Based upon the various Verizon and SBC Section 272(b)(5) affiliate transaction postings and
2 service offers provided on the companies' websites² and the first Verizon Section 272 Audit
3 report for New York,³ it has become apparent that the various interactions between the BOCs
4 and their respective 272 long distance affiliates raise serious questions as to the actual, *de*
5 *facto* extent of "separation" that prevails in practice as between the two supposedly separate
6 corporate units. A significant portion, although by no means all, of these interactions relate
7 in some manner to activities associated with the "joint marketing," joint account administra-
8 tion, and combined billing of the BOCs' local and long distance services. Each of these
9 activities is being undertaken by the BOC and its affiliate as if, for all practical purposes,
10 Section 272 did not exist.

11

12 6 The purpose of the Section 272(a) separate affiliate requirement, the Section 272(b)
13 code of conduct, and the Section 272(c) and 272(e) nondiscrimination requirements was *and*
14 *is* to forestall the potential for discriminatory and anticompetitive conduct arising out of the
15 ability, as an *economic* matter, of the BOC to extend its market power in the *local*
16 telecommunications market into the adjacent long distance market.⁴ The Commission has

17 2 <http://www.verizonld.com/regnotices/index.cfm?OrgID=1>;
18 http://www.sbc.com/public_affairs/regulatory_documents/affiliate_agreements/0,5931,199,00.html

19 3 *In the Matter of Implementation of the Telecommunications Act of 1996: Accounting*
20 *Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Reports of
21 Independent Accountants on Applying Agreed-Upon Procedures, prepared by Pricewater-
22 houseCoopers LLP, filed June 11, 2001 and June 18, 2001 ("New York 272 Audit Report")

23 4 *Conference Report on S. 652, Telecommunications Act of 1996* (House of
24 Representatives- February 01, 1996), *Congressional Record*, H1171.

1 previously noted that Section 272 contains all of the necessary elements to constrain BOC
2 exercise of this market power,⁵ however, empirical evidence from states with Section 271
3 approval indicates that, as currently applied, Section 272 is not by itself sufficient prevent
4 discrimination and anticompetitive behavior by the BOC for the benefit of its long distance
5 affiliate

6
7 7 Accordingly, for so long as the BOC ILEC entity continues to possess market power,
8 the Commission should extend the requirement that BOCs operate their interLATA business
9 activities through structurally separate affiliates as required by Section 272. Additionally,
10 however, the Commission must ensure that BOCs do not continue to undertake merely super-
11 ficial measures to comply with the separations requirements Unless Section 272 is complied
12 with in the manner intended by Congress and this Commission, consumers and competitors
13 will have no protection against anticompetitive conduct on the part of the incumbent BOCs

14

15 5 *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services*
16 *Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the*
17 *Interstate, Interexchange Marketplace*. CC Docket No. 96-149, 96-61, *Opinion*, Rel April 18,
18 1997 ("LEC Interexchange Non-Dominant Order"), 12 FCC Rcd 15756, at 15763

1 **Attainment by a BOC of Section 271 in-region interLATA authority cannot be construed**
2 **as demonstrating or implying that the BOC no longer has market power or that the**
3 **local service market in the state in which such authority has been granted has become**
4 **competitive.**
5

6 8 The instant consideration of either extending the separate affiliate and nondiscrimin-
7 ation requirements of Sections 272(a), (b) and (c) and/or of putting in place “any alternative
8 safeguards in states where the statutory requirements have sunset”⁶ must be made in the
9 context of the history and background that gave rise to the separate affiliate requirement in
10 the 1996 federal legislation That history begins with the U.S. Department of Justice’s
11 (“DoJ”) 1974 antitrust case against the pre-divestiture Bell System⁷ in which the DoJ alleged,
12 *inter alia*, that the Bell companies were using their local service monopoly to prevent
13 competition in the adjacent long distance market. The *Modification of Final Judgment*
14 (“MFJ”), the 1982 Consent Decree under which the former Bell System was broken up and
15 the Bell Operating Companies (“BOCs”) were divested from AT&T,⁸ prohibited the divested
16 BOCs from offering interLATA long distance services This *structural remedy* was adopted
17 specifically to prevent the BOC local service monopolies from using their monopoly market
18 power in the local services market to block competition in the adjacent long distance market

19 6 *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related*
20 *Requirements*, WC Docket No 02-112, *Notice of Proposed Rulemaking*, Rel May 24, 2002
21 (“NPRM”), at para. 1

22 7 *United States v Western Electric Company, Inc , et al*, Civil Action No 74-1698
23 (D D C)

24 8 *U.S. v Western Electric Co et al* , 552 F. Supp 131 (D. D C , 1982), *aff’d sub nom*
25 *Maryland vs U S* , 460 U S 1007 (1983), and *Modification of Final Judgment*, sec VIII.B.

1 And because the BOCs were themselves precluded from providing long distance services,
2 they were made to be *indifferent* as to which long distance carrier their customers might
3 individually select. Section 271 of the federal *Telecommunications Act of 1996* ("Act" or
4 "1996 Act") replaced the MFJ long distance "line of business" restriction with a process by
5 which BOCs could enter the "in-region" long distance market, provided that they
6 implemented a series of specific measures that, in principle, would have the effect of
7 irreversibly opening their previously monopolized local telecommunications markets to
8 competitive entry.⁹ To the extent that the *local* market itself becomes competitive, the
9 BOCs' ability to exert market power in the adjacent long distance market could be attenuated.
10 Conversely, when a BOC such as Verizon or SBC is allowed to offer in-region long distance
11 service in a less-than-fully-competitive local market, then the BOC acquires both the ability
12 and the incentive to engage in precisely the same type of anticompetitive conduct that the
13 *MFJ* was intended to prevent. In principle, this was also the purpose of Section 271

14
15 9 Section 271(c) of the 1996 *Act* sets forth the specific requirements that a BOC must
16 satisfy in order to obtain authority to provide in-region interLATA services. The BOC must,
17 if applying under "Track A," demonstrate that it has entered into at least one (1) inter-
18 connection agreement with a competing local service provider providing service (other than
19 by resale of the ILEC's services) to residential customers and to business customers, although

20 9 See, e.g., *In the Matter of the Application by Bell Atlantic New York for Authorization*
21 *Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in*
22 *the State of New York*, CC Docket No 99-295, *Memorandum Opinion and Order*, 15 FCC
23 Red 3953, 4164 ("*Bell Atlantic New York Order*")

1 the existence of one agreement with a single carrier providing service to both groups would
2 be sufficient (Section 272(c)(1)(A)). The BOC must also satisfy a “checklist” of fourteen
3 “specific interconnection requirements” that, for the most part, are reiterations of obligations
4 that are imposed by Section 251 upon *all ILECs* separate and apart from any long distance
5 entry *quid pro quo*

6
7 10 As interpreted by the FCC, Section 271 does not require a BOC to demonstrate that
8 actual entry has occurred, that competing services are available generally throughout the state
9 in question, or that the incumbent BOC has suffered or sustained any diminution of its
10 preexisting market power¹⁰. In fact, the FCC has on several occasions *rejected* arguments,
11 advanced by competing IXCs and others, that a BOC’s continued dominance and pervasive
12 control of the local market would make approval of its in-region interLATA entry contrary to
13 the public interest notwithstanding its apparent satisfaction of the “competitive checklist.”¹¹

14
15 11 Inasmuch as the threshold conditions for the FCC’s grant of in-region interLATA
16 authority do not require the BOC to demonstrate, or the FCC to find, that *effective competi-*

17 10 If the BOC is applying for Section 271 authority under “Track A” (i.e., Section
18 271(c)(1)(A)), it is only required to demonstrate that there is a minimum of just “one
19 competing carrier” offering service to residential and to business customers in the state
20 utilizing either the CLEC’s own facilities or UNEs leased from the BOC. *In the Matter of*
21 *Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of*
22 *1934, as amended, To Provide In-Region, InterLATA services In Michigan*, CC Docket No
23 97-137, *Memorandum Opinion and Order*, Rel. August 19, 1997, 12 FCC Rcd 20543, 20598.

24 11. See, e.g., *Bell Atlantic New York Order*, 15 FCC Rcd 4163.

tion has developed or that the BOC no longer has market power in the local service market in a given state, the fact that a BOC has obtained Section 271 in-region interLATA authority cannot be construed as implying that it no longer has market power or that the local service market in the state in which such authority has been granted — and particularly in all parts of that state — has become competitive. Indeed, in establishing the Section 272(a) and (b) separate affiliate requirements and the Section 272(c) and 272(e) nondiscrimination requirements, Congress clearly sought to dissociate a BOC's satisfaction of Section 271(c) with any finding or determination that it no longer had market power. On the other hand, Congress also understood that *if* the development of actual and effective competition in the local market were to occur, then the BOC's market power could be diminished or perhaps even eliminated. But Congress had no illusions about that taking place immediately upon enactment of the 1996 law, immediately upon a BOC's receipt of Section 271 authority in a given state or, for that matter, even after a finite and predetermined interval of time following such grant. Specifically

- Congress established an explicit "separate affiliate" requirement (Section 272(a)) that would be *mandatory* for *at least* three years following a BOC's long distance entry in a given state,
- Tolling of that three-year clock commences not as of the date of enactment of the 1996 law, but as of the date upon which the BOC's Section 271 authority becomes effective, separately for each state for which such approval is obtained; and

- 1 • The FCC is empowered to extend the separate affiliate requirement beyond the initial
2 three-year “sunset” period “by rule or order” and, based upon the Commission’s
3 determination in the instant *Notice*, may modify or adopt new rules pertaining to
4 such affiliate relationship as part of or in lieu of such an extension.¹²

5
6 Elimination of the separate affiliate requirement at a time when the BOC still maintains
7 extensive market dominance and market power would be inconsistent with, and would
8 therefore frustrate, the specific policy goals underlying Section 272

9
10 12 That the tolling of the three-year “sunset” period for Section 272(a) commences only
11 as of the date that the BOC obtains Section 271 authority, rather than as of the date of
12 enactment of the 1996 law (February 8, 1996) or the date at which the FCC promulgated
13 rules addressing the specific obligations applicable to ILECs for dealing with CLECs (August
14 8, 1996), further demonstrates Congress’ understanding that the mere establishment of formal
15 legal requirements does not by itself assure that they will be effective in achieving the legis-
16 lation’s goals. To the extent that *noncompliance* by the BOCs would work to extend their
17 legacy monopoly and forestall revenue erosion, BOCs continue to have strong financial and
18 business incentives to move as slowly as possible to open their networks to competition.¹³

19 12 *NPRM*, at para. 1

20 13 SBC’s Vice President for marketing, J. David Gallemore, was quoted in a 1995
21 *Business Week* interview as stating that “[w]e are at a critical juncture,” and “*we want to*
22 *make our welcome mat [for competitors] smaller than anyone else’s.*” “Pick of the Litter.
23 Why SBC is the Baby Bell to Beat,” *Business Week*, March 6, 1995 (emphasis supplied)

1 Congress understood and recognized that it could not *legislate* a competitive market into
2 existence, what it could do is to enact laws that would, if fully complied with, make
3 competition *possible* both as an economic and as a legal matter, and to adopt measures
4 designed to *encourage* the BOCs to take steps that are in other respects at odds with their
5 business and financial interests. Each and all of the “fourteen points” contained in the
6 Section 271(c)(2)(B) “competitive checklist” appear elsewhere in the statute as obligations
7 imposed upon *all* incumbent local exchange carriers *separate and apart from the matter of*
8 *long distance entry* (see Table 1 below). Viewed in that context, Section 271(c)(2)(B) is thus
9 *entirely redundant* at least insofar as specifying the things that BOCs (as ILECs) are required
10 to do to accommodate CLEC entry, its sole purpose was to offer the BOCs a “reward” that
11 perhaps would overcome their otherwise natural incentive to resist compliance to the greatest
12 possible extent. However, once the “checklist” has been “satisfied” and in-region entry has
13 been achieved, the compliance “carrot” will no longer be there, and those same business and
14 financial incentives will once again dominate BOC conduct.¹⁴ In expressly authorizing the
15 FCC to extend the sunset date for the Section 272 separate affiliate requirement, Congress
16 well understood that there is simply no basis to assume or to expect that merely as a result of

17 14 The FCC is cognizant of this “backsliding” potential, and has adopted measures
18 designed to overcome it. *Bell Atlantic New York Order*, 15 FCC Rcd 4174-4177. At bottom,
19 however, the entry “carrot” and the backsliding “stick” are in no sense symmetric because, as
20 a practical matter, it will be far more difficult to *rescind* a BOC’s in-region long distance
21 authority in the event of post-approval noncompliance than it had been to grant it as a reward
22 for (pre-approval) compliance.

Table 1 BOC Compliance with all of the Sec. 271(c)(2)(B) "checklist" items is Mandatory Even if the BOC Does Not Seek In-Region InterLATA Authority		
Checklist	Compliance requirement	Also Found At
1	Interconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1)	251(c)(2), 252(d)(1)
2	Nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).	251(c)(3), 252(d)(1)
3	Nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by the Bell operating company at just and reasonable rates in accordance with the requirements of section 224	251(b), 224
4	Local loop transmission from the central office to the customer's premises, unbundled from local switching or other services	251(c)(3)
5	Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services.	251(c)(3)
6	Local switching unbundled from transport, local loop transmission, or other services	251(c)(3)
7	Nondiscriminatory access to ((i) 911 and E911 services; (ii) directory assistance services to allow the other carrier's customers to obtain telephone numbers, and (iii) operator call completion services	251(b)(3); 251(c)(3)
8	White pages directory listings for customers of the other carrier's telephone exchange service	251(b)(3)
9	Compliance with guidelines, plan or rules established by numbering plan administrator	251(e)
10	Nondiscriminatory access to databases and associated signaling necessary for call routing and completion.	251(a); 251(c)(3); 251(c)(5)
11	Compliance with FCC regulations regarding number portability	251(b)(2)
12	Nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of section 251(b)(3).	251(b)(3)
13	Reciprocal compensation arrangements in accordance with the requirements of section 252(d)(2).	252(d)(2)
14	Telecommunications services are available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3).	251(c)(4) and 252(d)(3)

1 the passage of time (i.e., three years), the BOCs' market power would have diminished to the
2 point where that separate affiliate and associated nondiscrimination requirements are no longer
3 necessary

4
5 13 What Congress has done is to create a transition between the outright prohibition of
6 long distance entry that had prevailed under the MFJ, to unfettered BOC participation in
7 in-region long distance, using a transitional separate affiliate mechanism that could be
8 extended by the FCC beyond the minimum three-year period.¹⁵ This transitional mechanism
9 provides important safeguards against BOC anticompetitive conduct that had been
10 unnecessary under the pre-1996 MFJ "line-of-business" outright prohibition against long
11 distance entry. The Section 272(a) and (b) separate affiliate requirements and 272(c) and (e)
12 nondiscrimination requirements serve two separate objectives:

13
14 (1) By requiring that the long distance affiliate "operate independently" vis-a-vis the
15 BOC ILEC entity and by expressly prohibiting "discriminat[ion] between that
16 company or affiliate and any other entity in the provision or procurement of goods,
17 services, facilities, and information, or in the establishment of standards," the BOC is
18 limited as to the extent to which it can confer any unique competitive advantage,
19 arising from its incumbency and certain potential economies of network integration,
20 upon its affiliate long distance entity, to the detriment of nonaffiliated IXCs; and

21

22 15 47 U.S.C. § 272(f)(1)

1 (2) By requiring that the details of inter-affiliate transactions and transfers of assets and
2 services be made at fair market value, posted on the BOC's website, and ultimately
3 subject to periodic audit, BOC conduct that is inconsistent with the statute is made
4 more easily detectable than it would be if the BOC were permitted to conduct its
5 largely monopolistic local and competitive long distance businesses on a fully
6 integrated basis

7
8 The Congressional purpose for the separate affiliate requirement is not served if all that the
9 requirement entails are nominal bureaucratic constructs easily "satisfied" by the BOC and its
10 272 affiliate by merely maintaining facial separation.¹⁶ Yet on the basis of the affiliate
11 agreements entered into by Verizon and SBC and their 272 Affiliates, the pricing plans
12 offered by Verizon Long Distance and SBCS, as well as the reported results of the first
13 Verizon New York 272 audit, it is now evident that these two BOCs seek to interpret and to
14 apply the separate affiliate requirement in precisely that superficial a manner and, wherever

15 16. In Section 271 proceedings before state commissions, BOCs have made a special effort
16 to deflect attention away from any of the Section 272 requirements. For example, Dr.
17 William E. Taylor, testifying for Qwest in Minnesota, has actually claimed that "the Act does
18 not impose complete structural separation between a BOC and its 272 affiliate. Indeed, its
19 central requirement that transactions between the two be posted and made available to other
20 carriers is based on the assumption that the two will share services, that such sharing reflects
21 economies and efficiencies that should be permitted, and that the way to prevent any
22 anticompetitive behavior is to make those terms and conditions available to the competitors of
23 the 272 affiliate." Minnesota PUC Docket No. P-421/C1-01-1372, OAH Docket No. 7-2500-
24 14487-2, Affidavit of Dr. William E. Taylor, December 28, 2001, at para 7. At the very
25 least, it would appear that Dr. Taylor shares my view as to the importance of retaining the
26 separate affiliate and associated conduct and nondiscrimination requirements beyond the three-
27 year sunset date.

possible, to conduct their business transactions and relationships *as if the separate affiliate requirement did not exist*. Elimination of the separate affiliate requirement and with it the lens of public scrutiny of BOC inter-affiliate transactions will make conduct such as misallocation of costs and the resulting creation of cross-subsidies virtually undetectable, affording the BOCs opportunity and incentive to expand the scope of such anticompetitive behavior going forward.

BOCs retain market power in the local market and retain the ability to cross-subsidize their long distance services and to otherwise discriminate against nonaffiliated IXCs.

14 The FCC has defined market power as, *inter alia*, “the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable”¹⁷. In a competitive, multi-firm market, consumers are able to shift their purchases easily among the various suppliers in response to any unilateral action by any individual firm to raise its price above the competitive market level. Under these conditions, consumers can be expected to respond to a price increase initiated by any one firm by rapidly shifting their business to another provider whose prices have remained stable. As a result, the attempt by the first firm “to raise and maintain price above the competitive level” will not be successful, and could not be sustained. While BOCs have repeatedly claimed that they

¹⁷ *Competitive Carrier Fourth Report and Order*, 95 FCC 2d at 558, at para. 8 (citing *inter alia* W.M. Landes & R.A. Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev 937, 937 (1981), and A. Kahn, *The Economics of Regulation* 65-66 (1970)). The 1992 Department of Justice/Federal Trade Commission Merger Guidelines similarly define market power as “the ability profitability to maintain prices above competitive levels for a significant period of time.” 1992 Merger Guidelines, at 20,570